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Brian R Naranjo 02/11/2002 08:43:48 AM From DB/Inbox: Brian R Naranjo

Cable Text:

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TELEGRAM February 08, 2002

~~SPOT - APVSA~~
Chronic

To: SECSTATE WASHDC - ROUTINE

Action: WHA

From: AMEMBASSY CARACAS (CARACAS 348 - ROUTINE)

TAGS: ECON, EFIN, EPET, VE

Captions: SENSITIVE, SENSITIVE

Subject: PDVSA'S FISCAL POSITION DETERIORATES

Ref: None

RELEASED IN PART
B1, 1.4(D)

SENSITIVE BUT UNCLASSIFIED, PLEASE HANDLE ACCORDINGLY.

Summary

1. (SBU) While considerable attention has been focused on Venezuela's 2002 federal budget, the fiscal condition of the state-owned oil company, PDVSA, has worsened. PDVSA's weakened balance sheet will have ramifications for Venezuela's overall economy in the coming year because the Government expects PDVSA to provide a significant fiscal contribution to the national treasury. Considering lower oil production and prices, PDVSA will be hard pressed to raise sufficient funds to cover its investment budget (USD 4.3 billion), operating expenses (USD 7.7 billion), and expected contributions to the treasury (USD 9.9 billion). Capital markets have closed the gap between Venezuela's poorly regarded country risk (1,150 basis points) and PDVSA's traditionally higher-rated paper. Industry analysts are also increasingly concerned over the revenue impact of PDVSA's declining production as Venezuela continues to champion OPEC's restrictive supply policy. End Summary.

2. (U) Compared to 2001 when PDVSA generated USD 22.8 billion in revenue, the Government of Venezuela (GOV) estimates the state-owned oil company will produce USD 22.4 billion revenue in 2002. The company's gross profit last year was USD 11.7 billion, while 2002 estimated earnings are projected to be USD 9.9 billion. These figures, however, are predicated on an average oil price of USD 18.50 and production of 2.87 million bbl/day. According to the majority of industry analysts, it is highly unlikely that either of these conditions will be met.

3. (SBU) According to sensitivity analysis put together by a fiscal expert -- and former chief of the National Assembly's Economic Analysis Office -- at Venezuela's respected Institute for Higher Administrative Studies (IESA), PDVSA's financial results for 2002 could be 43 percent less than government projections. According to the IESA study, with production levels of 2.7 million bbl/day and an average price of USD 15.00/bbl, PDVSA's 2002 gross profits fall to USD 5.67 billion. (Note: Due to the relatively low API rating of Venezuela's oil, the average oil price is several dollars below market standards West Texas Intermediate and Brent; the average price for the week ending February 1 was USD 15.72. Following OPEC's latest quota reduction, Venezuela is supposed to produce 2.5 million bbl/day.)

4. (SBU) The federal fiscal crunch is developing because,

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despite higher taxes, more rigorous revenue collection, and possible reductions in planned 2002 spending levels, the GOV still depends heavily on fiscal contributions from PDVSA in the form of royalties, income taxes, and dividend transfers. In addition, the GOV will not be hesitant to tap PDVSA's share (USD 4.1 billion) of the USD 6.2 billion Economic Stabilization Fund if anticipated tax revenues fail to materialize. Both public statements by Central Bank Director Domingo Maza and a USD 850 million drawdown from the FIEM in late December support this possibility.

5. (SBU) Under current budget projections (USD 18.50/bbl price and 2.87 million bbl production), PDVSA would require only USD 400 million in financing to meet its 2002 expenditures. According to the more realistic IESA assumptions, however, the company's financing requirements increase to USD 3.3 billion. (Note: A late December 2001 GOV decision to suspend all payments to the FIEM -- including PDVSA's -- will greatly reduce its 2002 fiscal burden; in 2001 PDVSA contributed more than USD 1.5 billion to the rainy day fund.)

6. (SBU) Anywhere close to this amount of required financing would be very difficult to achieve in current capital market conditions. According to industry sources, PDVSA paid 4.5 percent over LIBOR (London Interbank Offered Rate) in their late December float of USD 600 million -- off a SEC shelf filing with a limit of USD 1.5 billion. Compared to early 2001, when the company enjoyed rates close to par to LIBOR, December's issuance indicates a clear loss of market favor. Almost all industry and financial sector participants concede that when PDVSA comes to market in 2002, the lending capacity will be there, but no longer will they enjoy gilt-edge rates.

7. (SBU) [redacted] B1

An eight percent reduction in personnel was announced and this will reduce operating expenses somewhat if wages can be controlled -- not a given considering that the powerful head of the country's largest labor union, Carlos Ortega, is demanding large increases in oil sector pay and benefits.

8. (SBU) A further uncertainty for PDVSA is the impact of the new Hydrocarbons Law. Under the new law, royalty payments have increased up to 30 percent (depending on the project) from 16.7 percent. This increase will be partially offset by a decrease in the income tax rate. The intent is clearly to front-load PDVSA's payment stream and avoid accounting procedures that might allow it to offset income and retain more of its revenues.

Comment

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10. (SBU) The stress of supporting increased federal expenditures and undertaking a sizable new investment program (to say nothing of increasing operating expenses that are associated with maturing fields) is beginning to show. With USD 7.1 billion in long-term debt at year-end 2001, PDVSA's debt service will exceed USD 850 million in 2002 (USD 409 million in interest payments; USD 475 million in amortization). The capital markets are already pricing these developments into PDVSA's long-term debt. If oil prices fail to rebound, the GOV will have to decide whether PDVSA will focus more on investment or continue to serve as the principal source of government revenue. End Comment.

Hrinak

Additional Addressees:
None

cc:

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E.O. 12958: N/A
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End Cable Text

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